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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 983

TELESERVICE COMPANY OF WYOMING VALLEY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

EDWARD P. MORGAN,
HERBERT E. FORREST,
710 Fourteenth Street, N. W.
Washington 5, D. C.
Attorneys for Petitioner

WELCH, MOTT & MORGAN,
710 Fourteenth Street, N. W.
Washington 5, D. C.
Of Counsel

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IN THE

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No.

TELESERVICE COMPANY OF WYOMING VALLEY, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in the above-entitled case on March 24, 1958.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court of the United States are reported at 27 T.C. 722 (1957) and appear in the record at pages 17-34. The concurring opinion of Judge Opper begins at page 31 and the dissenting opinion of Judge Kern begins at page 33.

The opinion of the United States Court of Appeals for the Third Circuit is not yet reported, and appears as Appendix A of this petition.

JURISDICTION

The judgment of the Circuit Court of Appeals sought to be reviewed was entered on March 24, 1958. On April 8, 1958, the Circuit Court of Appeals stayed the issuance of its mandate until May 8, 1958.

The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code, 28 U.S.C., § 1254(1).

QUESTION PRESENTED

Petitioner, a pioneer community antenna television system, finding sufficient risk capital unavailable, solicited funds from prospective subscribers toward the total cost of constructing its facilities. The sums received, which were not claimed as a basis for depreciation, have been held to be includable within taxable gross income, because only subscribers making contributions thereby became eligible to receive monthly service in return for the payment of monthly service charges.

The question presented in whether the doctrine enunciated by this Court in 1925 in *Edwards* v. *Cube Railroad Co.*, 268 U.S. 628, which has received a uniform application for thirty years, that reimbursements for capital expenditures are not includable in gross income although contributors may receive direct benefits from operation of the facility, is no longer applicable in income tax cases because of language interpreted as "an illuminating guide" in the decision of this Court in 1943 in *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98, holding that such contributions not included in gross income may not be allowed as a basis for depreciation.

STATUTE INVOLVED

Internal Revenue Code of 1939, as amended:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (Act of February 10, 1939, 53 Stat. 9, as amended, 26 U.S.C. (1952 ed.), § 22(a).)

STATEMENT OF THE CASE

The facts of this case are not in dispute, and are set forth in the opinion of the Court of Appeals printed in Appendix A hereto. They may be summarized briefly as follows:

Petitioner promoted, constructed, and operates a community antenna television system, a facility consisting of a master antenna mounted at a high elevation, with amplifiers, cable lines, and related equipment, which is designed to provide otherwise unavailable television programs to the residents of mountain-locked or fringe communities. In January 1951, when petitioner was organized to provide a first tele-

vision service to the cities of Wilkes-Barre and Kingston, Pennsylvania, which were effectively screened by intervening terrain from television reception through the conventional built-in, "rabbit-ear," or roof-top antennas, a single community antenna system had begun operation at Lansford, Pennsylvania, and a second was being constructed at Pottsville, Pennsylvania.

There was thus no adequate precedent to follow and insufficient information available based on past experience. It was expected that television stations would be established in the area in the near future to provide direct local service, and licenses were in fact granted in 1952 to area stations. It was known that it would be necessary to lay five miles of costly "dead" trunkline cable before a populated area could be reached to provide any significant potential for service. The cost of constructing the system was calculated to be as much as a quarter of a million dollars.

Because of the risks involved, and the impossibility of realizing a profit from undertaking the entire investment, petitioner decided that construction of the system would have to be financed essentially through contributions from prospective subscribers. Any profit to be realized would come from monthly service charges. Contributions of $145 were required of residential subscribers, and $200 upon commercial establishments, based upon the latter's ability to afford a greater amount. It was expected that anticipated contributions in these amounts would just about balance the estimated over-all costs of construction. Thereafter residential contributions were successively reduced to $89, to $80, to $30, and were finally abolished

in 1956. Monthly service charges designed to cover maintenance and to include an element of profit, in the amount of $4 per month to residential customers and $6 to commercial customers, have remained constant from the beginning.

Petitioner first erected the master antenna tower and laid five miles of cable to the first distribution area, using its own funds, before proceeding with successive stages of operation upon securing a sufficient number of prospective subscribers to enter into contracts. Petitioner agreed therein to furnish service, and the subscriber agreed to contribute a specified sum toward the total cost of constructing the system, which was a prerequisite to eligibility to use the system, and a monthly maintenance charge, payable in advance, which entitled him to receive television signals for that term. The contract also provided for forfeiture of contributions and charges in the event of termination, unless for the convenience of petitioner, in which case a partial refund on a sliding scale was provided. Potential subscribers were advised that the contributions were in aid of construction of the facility for supplying the television signals, and had no bearing on service, which would be charged as an extra item. A contributor could not sell, assign, or transfer his eligibility to receive signals, but remained eligible if he moved within the service area of the system, but a person moving into the contributor's old home was required to make a contribution in the amount then obtaining to become eligible. Connections fluctuated between a high of 900 and a low of 200 or 300.

During the two tax years in question, petitioner received total contributions of $116,146.77, and expended a total of $133,501.42 toward construction. The commu-

nity antenna system has no value as salvage. At no time did total contributions ever exceed total construction costs. All contributions were applied to construction costs, the operating costs being paid only from monthly service charges. All funds were deposited in petitioner's general bank account. However, its accounting system segregated the costs of construction, the amounts received as contributions, and the sums received from monthly maintenance charges.

In filing its income tax returns, petitioner did not include the contributions from subscribers in its gross income, and also did not claim an allowance for depreciation upon the physical facilities of the system, showing the accounting depreciation as a non-deductible item. The Commissioner, on the contrary, treated the contributions as gross income, but allowed a depreciation deduction, claiming tax deficiencies of $3,210.83 and $13,013.09 for the two taxable years in question.

Pursuant to the provisions of Section 6213 of the Internal Revenue Code of 1954, taxpayer filed a petition with the Tax Court of the United States on April 4, 1955, for a redetermination of the tax deficiencies claimed by the Commissioner. Findings of fact, opinion, and decision were filed on January 29, 1957, by Judge Tietjens of the Tax Court, after review by the Court (Opper, J., concurring, and Kern, J., dissenting), holding that the sums received toward the total cost of constructing the system constituted gross income within the meaning of Section 22(a) of the Internal Revenue Code of 1939. Pursuant to the provisions of Sections 7482 and 7483 of the Internal Revenue Code of 1954, a petition for review was filed on February 12, 1957, with the United States Court of Appeals for the Third Circuit, which affirmed the decision

of the Tax Court by opinion and judgment entered on March 24, 1958.

REASONS FOR ALLOWANCE OF THE WRIT

1. The Decisions of the Courts Below Are in Direct Conflict With Thirty Years of Judicial Application of the Doctrine of Edwards v. Cuba Railroad Co.

For thirty years until the instant case, every Court which has considered the question has uniformly held that reimbursements for capital expenditures are not taxable as income, although the contributors may receive direct benefits from operation of the facility, following the doctrine of *Edwards* v. *Cuba Railroad Co.*, 268 U.S. 628 (1925).[1] This Court had there stated, 268 U.S. at 632:

> "Such aids gifts and grants from the government, subordinate political subdivisions or private sources—whether of land, other property, credit or money—in order to induce construction and operation of railroads for the service of the public are not given as mere gratuities. * * *"

In that very case an entire series of direct benefits and concessions, including the right to specify routes and receive special rates, were granted by contract to the donor foreign government in return for its payments as reimbursement for railroad construction.

Thereafter, in those income tax cases where *Edwards* v. *Cuba Railroad* was held not applicable, the distinction made was not based upon any inquiry into the motives of or benefits to the contributors, but upon the nature of the funds in the hands and from the viewpoint of the taxpayer. In each such instance, *Edwards*

[1] Some of the cases following that decision, described by the Tax Court below as "voluminous authority", (R. 28), are set forth in that Court's decision. (R. 26). Cf. App., p. 9a.

v. *Cuba Railroad* was distinguished because the payments were related to operation and not to capital expenditures. As this Court said in *Texas & Pacific R. Co.* v. *United States*, 286 U.S. 285, 289-290 (1932):

> "The sums received under the act were not subsidies or gifts—that is, contributions to the capital of the railroads—and this fact distinguishes cases such as Edwards v. Cuba Railroad Co., 268 U.S. 628, where the payments were conditioned upon the construction work performed. Here they were to be measured by a deficiency in operating income, and might be used * * * just as any other operating revenues might be applied. * * *"

To the same effect are *Continental Tie & Lumber Co.* v. *United States*, 286 U.S. 290, 293-294 (1932); *Kansas City Southern Ry. Co.* v. *Commissioner*, 52 F. 2d 372, 378 (8th Cir., 1931), cert. den. 284 U.S. 676 (1931); *Boston Elevated Ry. Co.* v. *Commissioner*, 131 F. 2d 161, 164-165 (1st Cir., 1942), cert. den. 318 U.S. 760 (1943); *Helvering* v. *Claiborne-Annapolis Ferry Co. of Annapolis, Md.*, 93 F. 2d 875, 876-877 (4th Cir., 1938).

Indeed, the reference by this Court to the *Texas & Pacific R. Co.* case in *General American Investors Company* v. *Commissioner*, 348 U.S. 434, 436 (1955), a case relied upon by the Courts below to apply their broadened concept of taxable income, can only be interpreted as an affirmation of the test for non-taxable contributions there enunciated. In its companion case, *Commissioner* v. *Glenshaw Glass Company*, 348 U.S. 426 (1955), when it was in the lower Court, 211 F. 2d 928, 931 (3d Cir., 1954), Chief Judge Biggs restated without qualification in the same paragraph cited herein by the Court below (App., p. 15a), the applicable

rule: "If the property or money paid represents a return of capital or a contribution to capital it is not subject to income taxation."

The Courts below have now ruled that the funds received for construction of a capital facility are includable in gross income, if they are paid by prospective subscribers as a condition to their becoming eligible, upon prepayment of a monthly service charge, to obtain direct service from operation of the facility. No cases are cited directly in support, but reliance is placed upon language in *Detroit Edison Co.* v. *Commissioner*, 319 U.S. 98 (1943), as "an illuminating guide," (App., p. 12a), and upon the interpretation of that case in *Brown Shoe Co.* v. *Commissioner*, 339 U.S. 583 (1950) and *Commissioner* v. *McKay Products Corporation*, 178 F.2d 639 (3d Cir., 1949). But the non-taxability of the contributions as gross income was not before the Court in *Detroit Edison Co.* v. *Commissioner*, 319 U.S. at 103, or in *Brown Shoe Co.* v. *Commissioner*, 339 U.S. at 587 fn. 5.* The question there presented was whether such contributions could *also* be claimed as a basis for depreciation.

Two different tax worlds are concerned which cannot be so readily bridged as sought by the Courts below. One concerns income, the other a depreciation allowance. One is based upon constitutional limitation and

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* When that case was before the Court of Appeals, *Commissioner* v. *Brown Shoe Co.*, 175 F. 2d 305, at 311 (8th Cir., 1949), the Court quoted the Commissioner's brief as follows:

> "'Although the contributions here in question were undoubtedly contributions to the taxpayer's capital in the general sense of that term, so as to distinguish them from its income, they do not constitute "a contribution to capital" within the meaning of that term as it is used in Section 718(a)(1) and (2) of the Internal Revenue Code * * *.'"

statutory exclusion, the other upon a matter of legislative grace. One is to be construed strictly against the Government, the other against the taxpayer. One applies a test of capital as against operational expenditures, the other a test of direct as against indirect benefits. While both use the same phrase "contributions to capital," the *Cuba Railroad* income tax cases are based upon the distinction between capital and income, while the *Detroit Edison* depreciation cases turn upon the equating of "contributions" to "gifts" to secure a legislative exemption. In the *Cuba Railroad* doctrine, it was never a requirement that the "contributions" be gifts, as emphasized in the briefs and opinion filed therein.

Nor is an element of a community or public benefit a valid distinction to support the decisions below. Certainly there is no greater public purpose to be served in building railroad lines or subsidizing private factories than in extending railroad, gas, electric power, telephone, or water lines to rural areas, or, as here, in bringing a first or auxiliary television service to residents of screened areas. To promote and realize the maximum benefits of radio and television service to all the people of the United States has been expressly avowed to be a matter of national policy. *National Broadcasting Co.* v. *United States*, 319 U.S. 190, 217 (1943). By providing a facility for consistent, adequate, and satisfactory reception of television programs not otherwise available to isolated or fringe communities, the community antenna television system furthers this declared policy to secure and "make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate

facilities at reasonable charges * * *." Communications Act of 1934, Sec. 1, 48 Stat. 1064, as amended, 47 U.S.C., § 151.

The decisions of the Courts below are directly in conflict with a long line of heretofore unreversed decisions of the Board of Tax Appeals, predecessor of the Tax Court, as the Courts below have candidly conceded (App., pp. 15a-16a):

> "As to *Liberty Light & Power Co.*, 4 B.T.A. 155 (1926), *Great Northern Railway Co.*, 8 B.T.A. 225 (1927) aff'd 40 F.2d 327 (8th Cir. 1930), cert. den. 282 U.S. 855 and cases which followed the rule they enunciated, we can only say we are not in accord. We agree with the Tax Court that these cases cannot be distinguished factually."

The decisions of the Courts below are directly in conflict with the decision of the Court of Claims in *Texas & P. Ry. Co.* v. *United States*, 52 F.2d 1040 (Ct. Cl., 1931), aff'd 286 U.S. 285 (1932) (discussed supra in this petition), which held under circumstances which "cannot be distinguished factually" that payments by shippers to a railroad for constructing spur tracks for the use and benefit of the shippers were not taxable as income, although payments for operating deficits were so taxable.

The decisions of the Courts below are also in conflict with the opinion of Judge Learned Hand in *Bennet* v. *Helvering*, 137 F.2d 537 (2d Cir., 1943), which was decided only a few months after the *Detroit Edison* decision. In that case, although a taxpayer had never reported stock as income for tax purposes when it was received, the Second Circuit permitted the taxpayer to take a deduction for loss upon the stock, on

the reasoning that if property is subject to income tax, then it is subject to loss or depreciation whether or not ever actually declared as income. Since in the *Detroit Edison* case this Court had held that there was no basis for a depreciation allowance, Judge Opper said in the instant case, concurring in the decision of the Tax Court below (R. 33):

> "Basis for gain or loss and basis for depreciation being for all practical purposes identical * * * the reasoning of the *Bennet* case would mean that *Detroit Edison* must inferentially have decided that the contributions involved there had never been properly reportable as taxable income. In other words, if the *Bennet* result is right, the present conclusion must be wrong.
>
> "But since I think the theory of the *Bennet* case cannot be supported [footnote], I agree with this result."

2. The Decisions of the Courts Below Are in Direct Conflict With Thirty Years of Administrative Application

For thirty years, the Commissioner has uniformly applied the doctrine that funds paid as reimbursement for capital expenditures under circumstances which "cannot be distinguished factually" from this case are not includible as gross income, without regard to the direct benefits which may accrue from operation to the contributors who may be the only customers for service. See, e.g., *Midland Valley Railroad Co.* v. *Commissioner*, 19 B.T.A. 423 (1930), where the Commissioner conceded it was error to include payments by shippers for facilities to serve the parties making the payments in the computation of income subject to tax. As noted, in the *Detroit Edison* and *Brown Shoe* cases, the contributions were treated as non-taxable income. Indeed although *Detroit Edison* was

decided in 1943 and *Brown Shoe* in 1950, so far as is known never until the instant case has the Commissioner ever attempted to apply the language in those cases to income cases.

3. The Decisions of the Courts Below Are in Direct Conflict With Legislative Affirmation of Prior Interpretations Overruled by the Courts Below

In 1954, the Congress for the first time specifically provided in Section 118(a) of the Internal Revenue Code of 1954 that gross income subject to tax does not include contributions to the capital of a corporation. The detailed discussion of the bill in the House Committee Report, H.R. Rept. No. 1337, 83d Cong. 2d Sess. A38 (1954), states:

> "This section has no counterpart in the 1939 Code; however, the rule of this section, that contributions to the capital of a corporation are excluded from income, merely restates the existing law as developed through administration and court decisions. * * *"

To the same effect is the counterpart in the Senate Committee Report, Sen. Rept. No. 1662, 83d Cong., 2d Sess. 190 (1954). At that time, it must be noted, the Commissioner and the Courts below had not yet overruled thirty years of precedent, so that the cases which it is conceded "cannot be distinguished factually" retained their vigor as "existing law:"

4. The Decisions of the Courts Below Present an important Question in the Administration of the Federal Tax Laws and the Operation of a Substantial Number of Community Antenna Systems and Railroad, Gas, Electric Power, Telephone, and Water Companies

There are approximately 586 operating community antenna systems in the United States. A number of the earlier systems, including petitioner, have followed

the "contributions in aid of construction" theory in constructing their facilities, and consequently have cases pending before the Internal Revenue Service.

The effect of the decisions of the Courts below, however, will extend far beyond community antenna television systems to reach substantial numbers of railroads, gas companies, electric power companies, telephone companies, and water companies. The Court of Appeals, adopting the view of the Tax Court (R. 29), stated in the opinion below (App., p. 12a):

> "We are unable to discern any substantial factual distinctions between the initial payments made by the taxpayer's customers in the instant case and the payments made by the customers in Detroit Edison. * * *"

and has agreed with the Tax Court that the many cases now overruled involving these various facilities cannot be distinguished factually (R. 29; App., pp. 15a-16a).

Contributions in aid of the construction of capital facilities by prospective users is a necessary part of rules promulgated for the accounting systems of the various companies enumerated. See e.g., Federal Communications Commission, Uniform System of Accounts for Class A and Class B Telephone Companies, Section 31.2-20(b), 47 C.F.R., § 31.2-20(b); Interstate Commerce Commission, Uniform System of Accounts for Steam Roads, Section 2(c), "Cost," and 2(c)(1), "Donations from Individuals or Others," 49 C.F.R. §§ 10.10-2(c), 10.10-2(c)(1), and Account 734, "Donations and Grants," 49 C.F.R., § 10.734 (formerly 10.702½B); National Association of Railroad and Utilities Commissioners, Uniform System of Accounts for Electric Utilities, Gas Utilities, and

Water Utilities Class A and Class B, Account 265, "Contributions in Aid of Construction," and Instructions-Utility Plant Accounts, Instruction 3F.' The various companies concerned will be affected in a number of ways:

(1) Contributions heretofore not considered includable in gross income will now be taxed, presumably with retroactive effect, based upon the decisions in the instant cases.

(2) Pursuant to the various uniform systems of account, the companies will at the same time be denied a return on their properties from contributions because the sums received may not be included as a part of the rate base for rate making purposes.

(3) There is considerable question whether such contributions may be allowed as a basis for depreciation, under the decision of this Court in the *Detroit Edison* case if, as stated, there are no substantial factual distinctions (App., p. 12a).

(4) Many companies may be required to maintain a double set of accounting records, one for regulatory purposes and one for income tax purposes.

The decision of the Kansas Corporation Commission, In the Matter of the Investigation of the Kansas City Suburban Water Company, Inc., 22d Biennial Report (July 1, 1952—June 30, 1954), pp. 28, 37, is illustrative:

> "* * *[T]he Water Company transferred from its Account 241, Customers' Advances for Construction—Contingently Refundable, a total of $6,839.22 * * * representing certain contributions by customers for the construction [sic] of plant, which were no longer refundable under its contracts. Contrary to accepted practices the Company

credited this amount to Other Income, which amount should have been accounted for as Contributions in Aid of Construction as the Uniform System of Accounts now provides. The contention that no adjustment should be made because income tax has been paid on this amount is not logical for the reason that it was not income. The item should be deducted from the rate base and the Company will adjust its Account 265 to reflect such contributions."

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

EDWARD P. MORGAN,
HERBERT E. FORREST,
710 Fourteenth Street, N. W.
Washington 5, D. C.
Attorneys for Petitioner

WELCH, MOTT & MORGAN
710 Fourteenth Street, N. W.
Washington 5, D. C.
Of Counsel

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

No. 12,255

TELESERVICE COMPANY OF WYOMING VALLEY,
Petitioner-Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

Argued November 8, 1957

Before MARIS, KALODNER and STALEY, *Circuit Judges*

OPINION OF THE COURT

(Filed March 24, 1958)

By KALODNER, *Circuit Judge*

Were "contributions" received by the taxpayer, a television signal transmission service, from its customers, "toward the total cost of constructing" its facilities, under a contract which simultaneously provided for such "contributions" and the further payment of a "monthly main-

tenance charge", includable as "gross income" under Section 22(a) of the Internal Revenue Code of 1939?[1]

That is the issue presented by this petition for review of the decision of the Tax Court[2] which answered it affirmatively, thereby making the "contributions" toward the cost of construction taxable as gross income. The Tax Court's decision was premised on its "Ultimate Finding" that the "contributions" to the taxpayer ". . . were not gifts or contributions to capital; they were part of the payment for services rendered or to be rendered by the petitioner [taxpayer] and are includable in petitioner's [taxpayer's] gross income."

It must immediately be noted that the "Ultimate Finding" of the Tax Court ". . . was in the nature of an ultimate finding of fact and since such finding is but a legal inference from other facts it is subject to review free of the restraining impact of the so-called 'clearly erroneous rule' applicable to ordinary findings of fact by the trial court . . ."[3]

The facts may be summarized as follows:

Teleservice Company of Wyoming Valley ("taxpayer") is a Pennsylvania corporation. It promoted, constructed

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[1] "Sec. 22. GROSS INCOME.

(a) *General Definition.*—'Gross Income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit or gains or profits and income derived from any source whatever. . . ." 26 U.S.C. 1952 ed., Sec. 22.

[2] 27 T.C. 722 (1957).

[3] Phillber Equipment Corporation v. Commissioner, 237 F.2d 129, 131 (3d Cir. 1956).

and now operates for profit a community antenna television system at Wilkes-Barre and Kingston, Pennsylvania.

The residents of Wilkes-Barre and Kingston were unable by conventional television roof-top or built-in antennas to receive television signals of an adequate visual quality due to the fact that the cities are located in valleys surrounded by hills which effectively screened or cut off television signals which would otherwise be available for reception by conventional methods. Therefore, in January, 1951, the taxpayer's incorporators determined that a company should be organized for the purpose of providing television signals to the residents of the Wilkes-Barre area through a community television system.

In 1951 no licenses for Ultra High Frequency (U.H.F.) television stations (to provide a local, conventional television service to the area) had then been issued, but there were indications that such licenses would be granted in the near future, and it was known that at least one company in Wilkes-Barre would make application for such license. This created a hazard to investment of money in the enterprise contemplated by the taxpayer. In addition, taxpayer's founders determined that the construction of a community antenna system was an unknown business with no adequate precedent to follow and without definite information available on past experience.

Two community antenna systems were investigated—one in Lansford, Pennsylvania, which was observed in operation, and another in Pottsville, Pennsylvania, which was in the process of being constructed. The taxpayer was the third company of its type in existence.

After a study of some six months, the taxpayer selected a suitable location for the interception of television signals on top of the mountain range surrounding Wilkes-Barre and Kingston. It found that it would be necessary to run a trunk line of coaxial cables from the location selected to